

EXECUTIVE SECRETARIAT

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Executive Secretary

8/27/84

Date

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90892 add-onNATIONAL SECURITY COUNCIL
WASHINGTON, D.C. 20506

August 25, 1984.

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MEMORANDUM FOR:

MR. DONALD GREGG
Assistant to the Vice President
for National Security Affairs

MR. CHARLES HILL
Executive Secretary
Department of State

MR. CHRISTOPHER HICKS
Executive Secretary
Department of the Treasury

COLONEL R. J. AFFOURTIT
Executive Secretary
Department of Defense

MS. HELEN ROBBINS
Executive Assistant to the
Secretary
Department of Commerce

DR. ALTON KEEL
Associate Director for National
Security Affairs
Office of Management and Budget

EXECUTIVE SECRETARY
CENTRAL INTELLIGENCE AGENCY

THE HONORABLE HARVEY FELDMAN
Washington Representative to
U.S. Representative to the U.N.

MR. DENNIS WHITFIELD
Office of the U.S. Trade
Representative, Winder Bldg.

MS. TERESA COLLINS
Chief, Secretariat Staff
Executive Secretariat
U.S. Information Agency

BRIGADIER GENERAL GEORGE JOULWAN
Executive Assistant to the
Chairman
Joint Chiefs of Staff

SUBJECT: Issue Papers for NSC Meeting, August 28 (C)

Attached for your information are issue papers drafted by the
Departments of State and Treasury, respectively, for discussion
at the NSC meeting on IMF membership for Poland, to be held at
11:00 a.m., on Tuesday, August 28, 1984, in the Cabinet Room.
(S)

Robert M. Kimmitt
Robert M. Kimmitt
Executive Secretary

Attachments

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SECRETSTATE DEPARTMENTISSUE PAPER ON POLANDBACKGROUND

U.S. Policy Towards Poland: The U.S., in cooperation with its Allies, set sanctions against Poland after the imposition of martial law in December 1981 in order to persuade the Polish authorities to end martial law, release all political prisoners, and restore a genuine dialogue between the regime and the main components of Polish society. In a December 10, 1982 speech, the President laid out his step-by-step approach to relations with the Polish Government: "If the Polish Government introduces meaningful, liberalizing measures, we will take equally significant and concrete actions of our own."

Pursuant to this policy, in October 1983 we decided to resume Paris Club talks on Polish debt rescheduling and to allow discussions on fishing cooperation and in January 1984 the U.S. granted a Polish request for 88 charter flights and agreed that Poland could resume harvesting fish in the U.S. exclusive economic zone. These steps were taken in response to the release of the vast majority of political prisoners then under detention in Poland together with the formal end to martial law, the successful visit of the Pope to Poland in June 1983, and a December 1983 appeal from Lech Walesa that our sanctions be eased.

August 3 White House Statement: In response to the July 21, 1984 amnesty declaration in Poland, the White House announced on August 3 that the President had "authorized the lifting of the ban on landing rights for regularly scheduled flights of the Polish state airline LOT, subject to regularization of our civil aviation relationship, and the full reestablishment of scientific exchanges between the U.S. and Poland." In addition, the White House statement said that the President "has indicated that complete and reasonable implementation of the amnesty decision will create a positive atmosphere that would allow the reactivation of Poland's application for membership in the International Monetary Fund", stating that "the U.S. would of course consider any final application on its merits, including Poland's willingness to fulfill the obligations of IMF membership."

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IMPLEMENTATION OF THE PRESIDENT'S DECISIONS

General Implementation: In carrying out the President's decision, we have briefed our Allies in Washington as well as NATO. We informed the Vatican, given the Pope's special interest in Poland. We of course also informed the Polish Government in Washington and in Warsaw.

Reaction to the President's decision made public on August 3 has been generally positive. Our Allies, who all agree that the amnesty is a significant step, have been supportive. The Vatican, which in May gave us a note asking for the gradual elimination of sanctions, is pleased. Lech Walesa has said that as a Pole the decision makes him happy. Reiteration of the language about IMF in the President's August 17 remarks to a representative group of Polish Americans at a White House luncheon drew a prolonged round of applause. The mainstream Polish American Congress has advocated for months that the U.S. drop its opposition to Poland's membership in the IMF if eleven prominent political prisoners, the KOR Four and the Solidarity Seven, were released. On the other hand, the AFL-CIO continues to favor a cautious response, arguing that all sanctions should stay in place until trade union rights are fully restored. Pomost, a group largely composed of recent emigres from Poland, also opposes relaxation of sanctions.

Implementation of Air and Science Decisions to Date: An eleven-page Polish diplomatic note, delivered to us on August 16, characterized the President's decisions as positive, after lengthy, familiar argumentation about the unjust and illegal nature of our sanctions policy. The Polish note expressed willingness to enter into discussions on civil aviation and science exchanges, but without preconditions. Both sides initialed but did not sign a new science and technology agreement in October 1981; negotiations on that text or a somewhat modified version should pose no major obstacles. Discussion of a new civil aviation agreement will be more contentious. We have told the Poles that they must drop their arbitration claim against the U.S. under the now expired U.S.-Poland aviation agreement before we will sign a new agreement. It is unlikely that the Poles will readily agree to do this. Dates for discussion of these subjects will be set in diplomatic channels.

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Implementation of the IMF Decision: The prisoner-release phase of the amnesty was scheduled to end within thirty days of the announcement of amnesty and the question now is whether it has been carried out in a reasonable and complete fashion, as the President specified it must before we would in effect lift our opposition to IMF consideration of Poland's membership in the Fund.

Under the provisions of the amnesty passed by the Polish parliament on July 21, 1984, 35,000 prisoners were to be released from prison, including the 652 prisoners acknowledged by the government to have been convicted of, indicted for, or suspected of political crimes. Any amnestied prisoner convicted before December 31, 1986 of a crime similar to the one covered by the amnesty faces possible reimposition of the original sentence or charges. Underground Solidarity activists may be spared formal punishment if they turn themselves in to the authorities before the end of 1984, sign a detailed confession, and hand over any materials or equipment used in the underground.

Warsaw undoubtedly will soon claim that all 652 political prisoners acknowledged by the GOP have been released. Our Embassy in Warsaw, in close contact with the Church committee that maintains rosters of political prisoners (this contact should not be referred to publicly), will then attempt to confirm that the 652 prisoners are in fact out. To date all of the leading activists (the so-called Solidarity Seven and KOR Four) have been released, and there have been no reports of rearrests or blatant harassment of released political prisoners. One member of the Solidarity Seven, Jan Rulewski, as well as another prominent activist, Wladyslaw Frasyniuk, have been reprimanded by the authorities for addressing Church gatherings in a manner which could potentially threaten public order but neither has been incarcerated. So far the secret police have watched closely but not interfered with gatherings at churches to welcome the released political prisoners.

Two underground activists arrested in June, Bogdan Lis and Piotr Mierzejewski, have been accused of treason, a crime explicitly excluded from the amnesty, but neither has been formally indicted. It remains possible that the authorities will reduce the charges to an infraction included under the terms of the amnesty.

Next Steps: Once we have determined that the amnesty decision has been completely and reasonably implemented, we should inform our Allies, the Polish Government, and subsequently the public that the positive atmosphere has been created that would allow reactivation of Poland's application for IMF membership. A draft press statement along these lines is attached.

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DRAFT ANNOUNCEMENT

In accordance with the White House announcement of August 3, the President has determined that implementation of the release of political prisoners in Poland has created a positive atmosphere that will allow the reactivation of Poland's application for membership in the International Monetary Fund. As announced on August 3, the U.S. will consider any final application on its merits, including Poland's willingness to fulfill the obligations of IMF membership.

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Treasury Background Paper
on
Poland and the IMF

Poland was an original member of the International Monetary Fund (IMF) and the World Bank (IBRD) but withdrew from the institutions in 1950 rather than provide economic and financial data in support of its application for an IBRD loan. At the time, Poland charged that the institutions were American-dominated and serving U.S. international interests. A new application for membership was submitted in November 1981 and some preliminary discussions with IMF staff were held, but the discussions were effectively put on hold following the imposition of martial law.

Following the announcement by the Polish government of its amnesty decision, the President's statement of August 3, 1984 stated that:

complete and reasonable implementation of the amnesty will create a positive atmosphere that would allow reactivation of Poland's application for membership in the IMF. The U.S. would, of course, consider any final application on its merits, including Poland's willingness to fulfill the obligations of IMF membership.

This paper provides background on the procedures that the IMF would follow in processing Poland's application once the Fund is informed that the application could be reactivated. The paper also addresses some of the issues that might arise in connection with the application.

Membership Procedures

The IMF has established a series of procedural steps in considering all applications for membership. These include:

- submission of a written request for membership (Poland's 1981 application is still on the table);
- formation of an IMF technical team to collect the necessary economic data (including national income, exports and imports, official reserves, balance of payments, exchange rate and financial arrangements), review the country's economic policies, and to calculate a quota and the terms of payment of the quota subscription;
- formation of a "membership committee" of the Executive Board, composed of 5-8 Executive

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Directors, to consider the application and make a recommendation to the full Executive Board;

- preparation of a membership report for the Executive Board containing the proposed terms and conditions which the country has agreed to accept;
- submission of a membership resolution to the IMF Board of Governors which must be approved by a 50 percent majority vote (the U.S. has about 20 percent of the total IMF voting power); and
- completion of the necessary legal steps by the country to allow it to fulfill the obligations of membership and make the quota subscription.

In 1981, it was expected that the application process for Poland might take 8 to 9 months to complete. However, it is likely that a somewhat slower pace may be required this time and that the membership process could take about one year because:

- the IMF technical team on Poland has been dissolved and assigned to other countries. A new team will have to be assembled with technicians who were not involved in the earlier effort;
- IMF staff indicate that a technical team could not depart for Warsaw until October due to the September Fund/Bank meeting and other commitments; and
- there has been very little IMF contact with the Poles for the past two years, and the process of collecting data and assessing economic policies would essentially have to start over, possibly with Polish officials that are less reform oriented and technically competent.

The attached table sets forth a possible schedule for the membership application process.

Possible Issues Concerning Poland's Application

It is difficult to anticipate the particular problems that might surface during the application process. Based on past experience, including the 1981/82 IMF discussions with Poland, the following issues may arise.

- a) Data. As noted above, the IMF's data requirements are quite comprehensive, and timely and complete information is

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critical in assessing the applicant's economic policies and determining the appropriate quota. In the past, the Poles have been very vague regarding their current and prospective policies and have lacked basic data which the IMF would require. Failure to provide comprehensive and timely information could pose a problem in terms of Poland's ability to fulfill its membership obligation.

b) IMF obligations. The IMF requires that a country agree formally to fulfill all membership obligations. These include:

- pursuing policies that will promote orderly economic and financial conditions and avoiding manipulating exchange rates or its balance of payments to obtain an unfair competitive advantage;
- permitting its currency to be used in IMF operations by agreeing to convert IMF holdings of its currency into hard currency when it is in a relatively strong balance of payments and reserve position;
- obtaining prior IMF approval before the member may impose or intensify payments restriction and/or engage in discriminatory currency arrangements; and
- providing any information which the IMF deems necessary for its activities.

It could prove difficult for Poland to accept fully these obligations in light of its denunciation of the IMF at the time of the 1950 withdrawal (the Fund may insist on a repudiation of that statement) and questions about Poland's control over its economic policies. Moreover, the failure of Poland to meet its financial commitments to official creditors could also raise questions about its ability to fulfill IMF obligations.

c) Quota size. Negotiations on the size of a new member's quota are usually difficult, because of the importance of quotas in determining the amount of access to IMF financing, the share of any SDR allocation, and voting power. Preliminary estimates made in 1981 indicated a quota in the range of SDR 750 million (about \$765 million at current exchange rates). The Poles are likely to press for a larger quota although subsequent economic developments could, in fact, point to a lower figure.

d) Quota subscription. The IMF Articles of Agreement provide that a portion (about 25 percent) of the quota subscription be paid in reserve assets. The Poles may have difficulty getting enough hard currencies (about \$190 million) to make the payment, although it is certainly possible that commercial banks

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would be willing to provide financing on a short-term basis. (The hard currency quota subscription could be immediately reclaimed by the Poles).

e) Representation. The Poles would initially have to join an existing IMF constituency in order to be represented on the IMF Executive Board. (The Romanians are represented by the Dutch and the Hungarians by the Belgians.) However, membership in these groups could alter the voting power in the constituency and affect the ability of the Dutch and Belgians to elect the Executive Director. It is not clear what other member would be willing to represent Poland. Subsequently, the Poles, Romanians and Hungarians (and possibly Yugoslavia) might attempt to form their own constituency and elect an Executive Director, an event that could upset the present balance in the Executive Board and create an Eastern European "bloc" with troublesome implications for the IMF.

IMF Financing

Upon payment of its quota subscription, Poland could as indicated above, immediately withdraw its hard currency portion although this would not provide any net new financing. Beyond that, the completion of the membership process would not mean any immediate IMF credit to Poland. Traditionally, the IMF has resisted providing financing to a new member for at least six months following membership in order to be sure that the country is fulfilling the obligations of membership and to allow the new member time to develop experience with the IMF's operation and lending requirements. Moreover, any substantial IMF financing for Poland would require the negotiation and implementation of a major adjustment program to deal with the country's deep seated economic problems. It would likely take six months to a year following membership to negotiate and obtain approval for such an IMF adjustment program.

Under the IMF legislation enacted in 1983, the Secretary of the Treasury is required to certify and document in writing upon request and notify and appear, if requested, before Congress that certain criteria have been satisfied before the U.S. supports IMF financing for a communist dictatorship. The Secretary must determine, *inter alia*, that the IMF financing would provide a basis for correcting the country's balance of payments problem; reduce the severe constraints on labor and capital mobility or other highly inefficient labor and capital supply rigidities and advances market-oriented forces in the country; and is in the best interest of the majority of the people in the country. The implementation of this legislative requirement for Poland could pose serious problems.

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Relationship with IBRD (World Bank)

On joining the IMF, Poland would also become eligible for membership in the IBRD. Eligibility for borrowing from the IBRD would depend, inter-alia, on a calculation of Poland's per capita GNP in U.S. dollar terms and on Poland's willingness to liberalize its economy. Should Poland be found eligible, this would raise additional domestic political issues in the United States, and would seriously erode Congressional support for these institutions, particularly the IBRD which has come in for extremely sharp Congressional criticism in recent months.

Paris Club

Poland's outstanding debt totals \$27 billion; \$17 billion of this amount is due this year including \$11 billion in arrearages from 1981-1984. In March, the Paris Club creditors proposed, and the Poles accepted, a payments schedule to clear up outstanding arrearages under the 1981 rescheduling agreement. These payments were a precondition to rescheduling the remainder of the arrearages.

Currently, there is an impasse in the Paris Club regarding the Polish payments under the 1981 agreement. The impasse is due to a disagreement regarding two issues: the cutoff date for computing the initial Polish payment and whether the non-rescheduled amounts owed to the U.S. (\$35 million, including late interest) should be paid in full prior to the start of negotiations on Poland's 1982-84 debts. The Paris Club creditors are willing to be flexible on the cutoff date but have insisted that the U.S. be paid in full.

Recommendation

The IMF does not intend to proceed until it receives a clear U.S. signal that the conditions in the President's August 3 statement have been satisfied. Once these conditions are met and a determination has been made that the amnesty has been completely and reasonably implemented, the following steps should be taken:

- (1) State and Treasury will coordinate the preparation and release of a public statement on the implementation of the Polish amnesty which would be released following the consultations outlined below;
- (2) The Secretary of State will inform our Allies, the Vatican, and the Polish Government of our decision that the conditions for reactivation of Poland's application for IMF membership have been met;
- (3) The Secretary of the Treasury will inform the IMF that:

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- (a) The U.S. considers that the conditions for reactivating the Polish membership application have been met;
- (b) We would expect the IMF to follow the normal application procedures that apply to any country seeking membership; and
- (c) The United States will consider the final application on its merits, including Poland's ability and willingness to fulfill the obligations of membership.

Cleared by:

State/EB:Elinor Constable
State/EUR:Richard Burt

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THE WHITE HOUSE

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